Financial Reporting Changes for Pensions – What Do They Really Mean?

Overview

In June 2012, the Governmental Accounting Standards Board (GASB) issued two new accounting and financial reporting standards that substantially impact the reporting requirements for governmental pension plans and for employers participating in those pension plans.

The new GASB requirements do not directly impact the funding of the pension plans. Instead, these new requirements impact the financial accounting and reporting for the plans and their participating employers by requiring changes in the plans' determination of pension liabilities as well as significant changes in the reporting of those liabilities by participating employers. The changes represent a complete disconnect between the accounting for and reporting of pensions and the funding of pensions.

GASB's intent in adopting the new standards is to improve the way state and local governments report their pension liabilities and expenses, resulting in what GASB believes will be a more realistic representation of the complete impact of pension obligations. According to GASB, these changes will improve the decision-usefulness of the reported information and increase the transparency, consistency, and comparability of pension information across state and local governments. It is important to note, however, that the changes may result in confusion regarding participating employers' actual liability for pension benefits.

GASB Statement No. 67 affected reporting requirements for pension plans that administer benefits and was effective for fiscal periods beginning after June 15, 2013. The South Carolina Public Employee Benefit Authority (PEBA) implemented these changes in the South Carolina Retirement Systems' financial statements issued for the fiscal year ended June 30, 2014. The financial statements are available at http://www.retirement.sc.gov/financial/default.htm.

GASB Statement No. 68 affects reporting requirements for employers participating in the pension plans and is effective for fiscal periods beginning after June 15, 2014. This standard changes the way participating employers report the cost of and liability for employee pension benefits in their financial statements. A significant number of participating employers will implement these changes beginning with their financial statements for the fiscal year ended June 30, 2015.

Background and Disclosure Requirements

As active participating members work and contribute to their defined benefit retirement accounts, they are working toward earning a pension benefit that is expected to be paid in the future. Employers also contribute toward the cost of member pension benefits expected to be paid from the plan. If the pension plan's funding level is less than 100 percent, this means that some portion of the money needed for the plan to pay expected member pension benefits in the future is not currently held in the pension trust fund as of the date of measurement. Because the plan is expected to continue in perpetuity, if the plan's funding level is less than 100 percent, contribution rates are set at a sufficient level such that future contributions, along with investment earnings, will enable the plan to be 100 percent funded within the period provided for in the plan's funding policy.

The new GASB standards attempt to calculate the associated pension costs as of a specific point in time. The difference between the total anticipated cost of the plan's expected future benefits to be paid as of a certain date (Total Pension Liability or TPL), and the value of assets on hand to cover the benefits on that date (Fiduciary Net Position or FNP) is referred to as the Net Pension Liability (NPL). Participating employers previously reported an expense for employer contributions actually paid during the fiscal year as required by state law to help fund the pension plan, referred to as the annual required contribution (ARC); as long as the ARC was paid, there was no corresponding liability to report. GASB 68 now requires participating employers to report a proportionate share of the NPL in the employer's financial statements regardless of the funding progress. In addition, employers are required by GASB 68 to include significantly expanded note disclosures and required supplementary information regarding their participation in the plans.

In addition to the inclusion of the NPL in participating employers' financial statements, the new standards require a change in the way the plan calculates the NPL for financial reporting purposes. The GASB requirement of determining the value of assets on hand to cover benefits is tied to "fair market value," and, because of the inherent volatility of investment market values, may result in more frequent and larger fluctuations in the amount of the pension plan's NPL for accounting and financial reporting purposes. Comparatively, this differs from the method used in determining the actuarial liability of the plans for funding purposes where fluctuations in investment market value were recognized using actuarial smoothing methods. Smoothing techniques defer a portion of investment gains and losses each year to dampen the short-term volatility inherent in investment markets and are intended to produce an actuarial asset value that is fairly consistent with market values during periods of ordinary investment returns. Smoothing results both in more stable contribution rates and in a more level funded status and is also a valuable methodology for budgetary planning purposes for governmental entities. Actuarial smoothing will continue to be used in the determination of the required employer and employee contribution rates for funding purposes.

The changes required by GASB 67 and 68 are likely to result in increased volatility in the reported NPL, which will flow through to participating employers' financial statements as they record their proportionate share of the NPL and its changes from one year to the next. Additionally, the inclusion of the liability may make an employer appear insolvent on its financial statements. Regardless of the NPL reported on an employer's financial statements, the employer is responsible only for making the contributions required by state law during any given year. Employers cannot pay down or pay off their proportionate share of the NPL with additional contributions as the plans are unable to accept contributions in excess of those required by state law. In addition, employers cannot discontinue their participation in the plan as the election to participate is irrevocable.

Conclusion

This document is intended to provide an introduction to and a high level overview of the accounting rule changes and the impact they will have on the participating employers. PEBA's staff is working with individual employers, various associations, and public accounting and auditing firms to make sure all stakeholders are aware of the accounting rule changes. PEBA's staff is also working closely with the plan's consulting actuary and external audit firm to ensure that PEBA has the facts and figures necessary to provide participating employers with accurate, timely information in response to the requirements of the new standards.

What is GASB?

- An independent organization responsible for developing standards for accounting and financial reporting by state and local governments
- It works to improve government accounting and is recognized as the official source of generally accepted accounting principles (GAAP) for state and local governments

Get More Information

- More information is available at PEBA's Retirement Benefits GASB Resource Center located at http://www.retirement.sc.gov/gasb/resourcecenter.htm.
- Technical information about GASB Statement No. 67, *Financial Reporting for Pension Plans* and GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, is available at www.gasb.org.